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No.

Supreme Court, U.S.
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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1982

FRANK J. LAIRD,

Petitioner

v.

INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,

Respondents

THE KANSAS CITY
SOUTHERN RAILWAY COMPANY,

Intervenor

**PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF
APPEALS FOR THE THIRD CIRCUIT**

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QUESTIONS PRESENTED

1. Whether, in a context in which Federal law governs, i.e., the issuance of securities by a railroad regulated by the Interstate Commerce Commission, a majority stockholder has an absolute right to eliminate minority stockholders by tendering them cash for their securities, without their consent, and without being required to demonstrate how the overall interests of the railroad will be benefited as a consequence of such action.

2. Whether, in such a context, where a crucial question should be the bona fides of the professed motives of the railroad's management — a management selected and controlled by the majority stockholder, the Interstate Commerce Commission may approve the freeze-out while denying the minority the right to both essential discovery and a hearing.

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**PETITION FOR WRIT OF CERTIORARI
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OPINIONS BELOW

The Decision and Order of the Interstate Commerce Commission ("the Commission") dated February 8, 1982, is attached to this Petition as Appendix "A". The Opinion and Judgment of the Court of Appeals is reported at 691 F.2d 147 and is attached to this Petition as Appendix "B".

JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). The judgment of the Court of Appeals was entered on October 14, 1982. A timely petition for rehearing was denied on November 24, 1982. This Petition was filed within sixty days of the Order of the Court of Appeals denying a rehearing.

STATUTES INVOLVED

This case involves Section 11301(d) of the Interstate Commerce Act, 92 Stat. 1428, 49 U.S.C. §11301(d),¹ and certain Rules of Practice of the Commission providing for a "Modified Procedure", namely, 49 C.F.R. §1100.43, 49 C.F.R. §1100.51, and 49 C.F.R. §1100.55, which are set forth in Appendix "C".

Also involved and set forth in Appendix "C" are 28 U.S.C. §§2321(a), 2342(5), 2344, statutes which define the jurisdiction of the Court of Appeals to review the final Order of the Interstate Commerce Commission in the first instance.

1. 49 U.S.C. §11301 provides in relevant part:

"§11301. Authority of certain carriers to issue securities and assume obligations and liabilities

* * *

(d)(1) The Commission may begin a proceeding under this section on application of a carrier. Before taking final action, the Commission must investigate the purpose and use of the securities issue or assumption and the proceeds from it. . . . The Commission may approve an application under this section only when it finds that the securities issue or assumption —

(A) is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose;

* * *

STATEMENT OF THE CASE

1. The Proposed Transaction And The Railroad's Application To The Commission.

Petitioner ("Laird") is the owner of 1,069 shares of common stock of the Kansas City Southern Railway Company ("the Railroad").

By a Decision and Order dated February 8, 1982,² the Interstate Commerce Commission ("the Commission"), pursuant to an application filed by the Railroad under 49 U.S.C. §11301, authorized the Railroad to implement a reverse stock split under which the Railroad would reissue and exchange one share of preferred stock for each 7,000 shares of preferred stock outstanding and one share of common stock for each 2,000 shares of common stock outstanding ("the Transaction"). The result of the Transaction will be the elimination of stock interests in the Railroad of all parties except the Railroad's parent, Kansas City Southern Industries, Inc.; all of the Railroad's minority shareholders will be required to accept cash in exchange for their shares.

Under the terms of the Transaction, common shareholders such as Petitioner would be required to accept \$210 per share for their stock, a price which would be \$825 a share less than the stock might be worth in the event the Railroad were merged and a fair price paid for its plant, property and equipment, much of which is, as pointed out *infra* (at pp. 5-6), of recent vintage. The Railroad's 70 preferred shareholders, whose securities had a par and book value of \$50 per share and were supposed to be noncallable, would be paid only \$30 per share, or \$20 less than book, for their holdings.

Petitioner, and other common and preferred shareholders who filed objections to the Transaction before the Commission, have no present interest in selling their

2. A copy of the Decision and Order of the Commission is attached as Appendix "A".

shares for any price. They also contend that the Railroad's real purpose is to defraud its minority shareholders, who had remained loyal to the Railroad and foregone dividends in times of stress, by forcing the minority to sell, and so preventing them from benefiting (the same as the majority shareholder-parent company) from increased future earnings and from any potential merger or acquisition.

The parent company and its subsidiaries own or control more than 99 percent of the Railroad's common stock issued, i.e., 1,018,052 shares. The remaining 1,948 shares of common stock are held by approximately 28 persons — with Petitioner being the record owner of 1,069 shares, or about fifty-five (55%) percent.

The purpose for the Transaction, as set forth in the Railroad's Application to the Commission, was as follows:

“ *** to increase the efficiency and economy of the Applicant's operations by eliminating certain costs of reporting and record retention necessitated by ownership by a few minority shareholders of an insignificant percentage of its stock; by eliminating any potential of future conflicts of interest between minority shareholders of Applicant and its parent, Kansas City Southern Industries, Inc.; by eliminating the necessity of retaining the capability of transferring stock, and by facilitating mergers, acquisitions and other business ventures that might be undertaken by Applicant”.

In its various submissions to the Commission, the Railroad simply reiterated these conclusory statements without offering any further substantiation whatever. For example, the Railroad failed to produce any evidence whatever for the Commission of any dollars to be saved or any personnel to be eliminated by cashing out the 98 minority shareholders. As a matter of fact, the savings must have been minimal, since the Railroad took no is-

sue with Petitioner's sworn assertion that the Railroad's communications with its shareholders were infrequent, and that the task of maintaining contact with those shareholders had in fact been performed by personnel of the Railroad's controlling shareholder — which has more than 4,000 shareholders itself.

The sole basis on which the Railroad purported to justify the price tendered to the minority shareholders consisted of a two page opinion letter prepared for \$5,000 by an investment banker (Kidder, Peabody & Company), who was consulted originally by the Railroad's majority stockholder in connection with resisting a takeover. That expert's sworn answers to interrogatories showed that the only matters which it considered in pricing the stock were the dividends and cash flow of the Railroad, past and prospective, and evaluations of individual shares of common and preferred stock in the Railroad based on comparisons with the market values, in a public trading context, of the securities of various railroad holding companies. The answers were equally clear in disclosing that the investment banker gave no consideration whatever to the actual market value of the Railroad as a whole, or of its assets, although merger is, obviously (see page 6-7, *infra*, and Appendix "F" to this Petition), a very real possibility for this Railroad, and many factors other than dividends and earnings are, and legally must be (pages 16-17, *infra*), considered in evaluating a railroad's securities for purposes of merger.

2. Facts Concerning The Railroad And The Historical Treatment Of Its Minority Shareholders.

Significant, and undisputed, facts concerning the Railroad and its treatment of its minority shareholders previous to the proposed cash-out include these. The Railroad operates 1,600 miles of road in the south central United States. After sustaining substantial losses in 1971 and 1973, the Railroad undertook a significant

maintenance of way and capital improvement program in anticipation of increased heavy unit coal train traffic. This coal originates in the newer coal fields of the West and travels to newly industrialized South and Gulf ports. The Railroad spent \$101 Million between 1973 and 1977 for capital improvements designed to equip the Railroad to handle this traffic and to lay the foundation for the huge growth in earnings which the Railroad has experienced since 1977.

Neither common nor preferred shareholders received any dividends during the rebuilding period.

Between 1975 and 1980, as a result of the rebuilding, the Railroad's sales increased 108%, to \$277 Million; its net income increased 23 times, from \$1 Million to \$23.6 Million; its earnings per share of common stock increased 17 fold, from \$1.34 in 1975 to approximately \$22.50 in 1980. Notwithstanding, common shareholders received dividends of only \$4.00 a share in 1978, \$7.00 a share in 1979, and \$9.00 a share in 1980 and preferred shareholders received dividends of only \$2 per share in each of those years.

In recent years, in terms of revenue per ton mile, the Railroad's record was the second best in the industry, and its revenue per ton mile increased at a rate which was three times the industry average. On the other hand, the ratios of the Railroad's expenses for transportation and maintenance and the Railroad's operating ratios were among the best in the industry.

As noted, the 1,069 shares of the Railroad's common stock owned by Petitioner represents 55% of the outstanding minority common stock interest. The value of that stock as of December 31, 1979, according to the Railroad's own figures, would have been \$1,035 per share, if the Railroad's plant and newly renovated property and equipment were valued at current cost, net of accumulated depreciation and amortization, rather than its book value of \$130 at the end of 1980, i.e., less than one year prior to the Railroad's vote in favor of a freeze-out.

The interests of these minority shareholders were such — the minority common stock interest was only 1% — that they were in no position, legally or factually, to prevent or obstruct any merger, and as a matter of fact, the minority had supported the Railroad's management prior to the proposed freeze-out.

3. Proceedings Before the Commission; The Commission Granted Only Limited Discovery And Denied Petitioner An Oral Hearing.

Petitioner filed a formal protest with the Commission in which he averred that there was no valid business reason for the proposed Transaction and that the rationale for it presented by the Railroad was neither substantive nor real; that the actual value of the common stock, in terms of the value of an extremely profitable and growing operating Railroad which is an attractive candidate for merger with a larger line, was well in excess of the compensation being offered, and that any potential conflict of interest between the Railroad's parent company and the minority shareholders would be possible only because of the improper conduct of the Railroad's management over the preceding six (6) years in failing to declare fair dividends and paying inordinate and unjustified management fees to the parent.

In this initial submission, Petitioner made the first of a number of requests for a public hearing, representing that good cause existed as required by the pertinent regulation.

The Railroad's Reply did not present any additional facts to demonstrate that the Transaction was for a lawful object within the corporate purpose and was reasonably appropriate for that purpose.

Thereafter, the Commission rendered a Modified Procedure Decision which set forth a schedule for submission of verified statements by the parties and directed that, except for good cause shown, requests for

cross-examination of witnesses or for other relief would not be acted upon prior to receipt of the verified statements.

The Railroad's verified statement, styled Statement of Facts and Argument, did not amplify in any substantive manner its two prior filings, but instead reiterated that the main purpose to be served by the Transaction was the elimination of expense — not otherwise calculated, described, or documented — of maintaining a shareholder support system. The Railroad also provided a verified statement of a Vice President of Kidder Peabody, which set forth cryptic descriptions of three valuation methods — equity evaluation model, discounted cash flow method, and capitalized earnings method — utilized to arrive at Kidder Peabody's opinion of the fair value of the common and preferred stock held by the public.

Petitioner requested the Commission to change its Modified Procedure Order to permit discovery before he responded. He needed discovery, he averred, because without discovery, he could not intelligently and reasonably respond to the Railroad's submissions. In this connection, Petitioner outlined specific areas of inquiry which he said he needed to probe in order to evaluate (a) the Railroad's arguments that the elimination of expenses of maintaining a stockholder support system for a relatively small number of shareholders justified the freeze out, (b) why and to what extent, if at all, the Railroad's standing as a potential candidate for merger or consolidation would be enhanced absent a few minority shareholders, and (c) how the mere existence of minority interests created a potential for future conflicts with respect to transactions between the Railroad and its parent company, and how such alleged conflicts would differ in any material way from the situation presented in any other instance in which the majority of the stock is held by a parent company and the minority is held by the public. In this regard, Petitioner sought to depose

four named executives of the Railroad and to examine various documents in that connection.³ The description of those documents was so specific as to leave no unanswered questions as to their relevance to the Transaction involved and the subjects which would be probed in the depositions.

The Commission rendered a Decision on Discovery⁴ which denied Laird's request to take depositions, denied the request for production of documents from the Railroad, granted limited production of documents provided by the Railroad to Kidder Peabody, and permitted discovery of Kidder Peabody's representative by written interrogatories only. In denying the request for depositions, the Commission stated that Petitioner had not been specific enough, that the areas of inquiry concerning the "business purposes underlying the Transaction" were not sufficient to authorize the "interruption of the management" of the Railroad, and that the requested depositions would encompass "matters which may or may not be related to the fundamental issues in this proceeding." This was said notwithstanding the facts that, under the law, a finding of a valid corporate purpose is mandatory (p. 2, fn. 1, *supra*), and many of the specified areas of intended inquiry were directly relevant to the alleged business justification for the freeze-out stated by the Railroad.

Subsequently, both Petitioner and the Railroad submitted additional verified statements, and in his submission, Petitioner again requested an oral hearing pursuant to the Commission Rules of Practice.⁵

The Railroad's verified statement did not present any additional information or reasons to support its conclusion, first submitted in the Application (p. 4, *supra*). Once again, the Railroad took the position that it was not

3. The Requests for Depositions and Document Production are set forth in Appendix "D" to this Petition.

4. This Decision is Appendix "E" to this Petition.

5. 49 C.F.R. §1100.51.

necessary for the alleged reduction of expenses of maintaining the shareholder support system to meet any standard of substantiality, and that the elimination of a negligible minority interest can *ipso facto* be a corporate benefit.

The Railroad contended that the only real issue was the amount of compensation which should be paid to the minority for their interests. In the Railroad's view, the essence of Petitioner's complaint was that he simply wanted more money. This was not so. Petitioner's verified statement averred, *inter alia*, that he was satisfied with his investment and objected to a forced sale. The Railroad also asserted, erroneously, that Kidder Peabody had valued the Railroad as an on-going business.

The Commission's Decision and Order of February 8, 1982, authorized the Transaction. In its Decision, the Commission concluded that a valid business purpose existed, that the proposed compensation for minority shareholders was adequate, and that the Transaction was in compliance with applicable law. The Commission also denied Petitioner an oral hearing.

On February 25, 1982, pursuant to 28 U.S.C. §§2321(a), 2342(5) and 2344, Petitioner filed a Petition for Review in the United States Court of Appeals for the Third Circuit. His contentions there included the two contentions asserted here, namely, that the Commission's decision that the Transaction was for a valid business purpose was not supported by substantial evidence, and that the Commission's actions in denying proper discovery and an oral hearing were arbitrary and capricious and constituted an abuse of discretion.⁶

6. Petitioner also contended that the Commission had erred, as a matter of law, in approving the cash terms of the freeze-out even though it was clear beyond doubt that the Railroad was a prime candidate for a merger and on terms favorable to the Railroad, but that, notwithstanding, the Railroad's valuation expert had given no consideration whatever to the prices which might be paid for the Railroad by a party interested in a merger.

REASONS FOR GRANTING THE WRIT

1. In Affirming The Commission, The Court Below Decided, Contrary To The Rule Followed By The Majority Of State Courts, Its Own Decisions In Other Cases Involving State Laws, And The Opinions Of Many Respected Commentators, That The Majority Shareholder Of A Federally Regulated Carrier Has An Absolute Right To Cash Out The Minority Shareholders, Solely For Its Own Convenience. Such A Holding Is Supported By No Federal Precedent Whatever And Is Contrary To A Specific Holding Of This Court In An Analogous Situation.

In order to approve the Transaction, the Commission was mandated to find that a valid business purpose existed. Section 11301 of the Interstate Commerce Act provides, in relevant part, that "the Commission *may approve* an application under this section *only when* it finds that the securities issue or assumption "****" is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose".⁷

In its Decision, the Commission did nothing more than accept the Railroad's averments that the elimination of the cost of its shareholder support system for the very small number of minority shareholders and the avoidance of a *possible* conflict of interest between the *parent company* and the minority shareholders provided a "reasonably appropriate corporate purpose" for the freeze-out.

The Railroad provided the Commission with no concrete evidence whatever as to the presumably minimal cost of maintaining the shareholder support system which was to be eliminated. The Railroad, for instance, submitted no evidence relative to (1) the methods it had used to communicate with minority shareholders and

7. 49 U.S.C. §11301(d)(1)(A).

the cost of maintaining that capability, or (2) the frequency of, and need for records relative to, the transfer of stock, including materials pertaining to lost stock certifications, and (3) the expenses involved in otherwise corresponding and dealing with the relatively small number of minority shareholders. This is especially relevant in view of the fact that the Railroad's own documents demonstrate that the small number of minority shareholders are long-term investors. Furthermore, the Railroad did not contradict Petitioner's averments that nearly all of the stockholder support services performed for the Railroad were undertaken by parties and personnel who performed similar services on behalf of the Railroad's parent company, and that the only communications which Petitioner had received from the Railroad over the past few years had been occasional quarterly and annual reports.

Neither did the Railroad offer any concrete evidence to support its contention that the mere existence of minority shareholders necessarily created the potential for future conflicts with respect to any transaction between the Railroad and its parent company (the majority stockholder). Certainly, in any event, the Railroad did not advance any reasons to show that any potential conflicts would differ in any material way from the situation which would be presented in any other corporate situation in which the majority of the stock were held by a parent company and the minority were held by the public. It is uncontradicted that Petitioner, who himself owned 55% of the minority common stock outstanding, never offered any opposition to any activity of the Railroad in the past, and never received any communication indicating that any other minority shareholder had done so.

Also, as stated above, when Petitioner sought discovery to ascertain factual details relative to these contentions, the Railroad resisted, and the Commission denied such discovery.

In its decision on the merits, the Commission concluded that, under Missouri law, the Transaction was lawful, and rejected the authorities, arising primarily under Delaware law, which Petitioner had cited to support his contention that a reverse stock split intended solely to "freezeout" minority equity holders is unlawful. Petitioner urged, and still urges, that this finding constituted error.

First of all, the legal standard which the Commission should have applied is a federal, not a state, standard. *Schwabacher v. U.S.*, 334 U.S. 182, 68 S.Ct. 958, 92 L.Ed 1305 (1948). Under 49 U.S.C. §11301 and *Schwabacher*, the Commission could approve only if it found the Transaction was for a lawful object within the corporate purpose of the Railroad and reasonably appropriate for that purpose.

The Railroad contended, and the Commission erroneously accepted the proposition, that the elimination of a small number of minority shareholders can, in and of itself, be a valid business purpose, and that a "reverse stock split", having as its sole purpose the elimination of the minority, is a generally accepted statutory mechanism. But, the majority and enlightened view is that the rights of a minority shareholder are premised on a fiduciary duty owed by the majority shareholder to the minority. Most courts, including the court below in several cases based on state law, have held that a majority shareholder can meet the fiduciary standard only by establishing that there is a valid purpose, *from the standpoint of the corporation as a whole*, for the "freeze-out", and that a reverse split whose sole purpose is the elimination of minority shareholders is not lawful. See, e.g. *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981); *Dower v. Mosser Industries*, 648 F.2d 183 (3d Cir. 1981); *Singer v. The Magnovox Company*, 380 A.2d 969 (Del. Supr. 1977); *Tanzer v. International General Industries, Inc.*, 379 A.2d 1121 (Del. Supr. 1977); *Kemp v. Angel*, 381

A.2d 241 (Del. Ch. 1977).⁸ In *Pittsburgh Terminal Corp. v. Baltimore & Ohio Railroad, Co.*, 680 F.2d 933 (3d Cir. 1982), three judges of the court below who did not participate in the present decision referred to "the settled rule that a control stockholder owes a fiduciary obligation not to exercise that control to the disadvantage of minority equity participants." The same judges expressed doubt that the courts of any state would ever hold to the contrary.

See also: Borden, *Going Private—Old Tort, New Tort or No Tort?* 49 N.Y.U.L. REV. 987 (1974); Brudney and Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978); Greene, *Corporate Freeze-out Mergers: A Proposed Analysis*, 28 STAN. L. REV. 487 (1976); Lorne, *A Reappraisal of Fair Shares in Controlled Mergers*, 126 U. PA. L. REV. 955 (1978).

Also, the SEC recently promulgated a rule requiring the issuer to comment on the fairness of the transaction to the minority. 17 C.F.R. §240.13e-3 (1980). For discussions of this rule, see Note, *Regulating Going Private Transactions: SEC Rule 13e-3*, 80 COLUM. L. REV. 782 (1980); Note, *Freezeout Merger Regulation: An SEC Rule Joins State Efforts*, 37 WASH. & LEE L. REV. 964 (1980).

8. The Railroad has cited *Teschner v. Chicago Title & Trust Company*, 59 Ill.2d 452, 322 N.E.2d 54 (1974), in support of its position. However, *Teschner* is distinguishable in that, there, the minority shareholder "did not allege or show any improper purpose on the part of the [majority] defendants". 322 N.E.2d at p. 58. The Railroad and the Commission also cited *Missouri Pacific Ry. Co., Securities*, 347 I.C.C. 377 (1973), *sub nom. Gabriel v. United States*, 416 F.Supp. 810 (D. N.J. 1976) *aff'd mem.* 429 U.S. 1011, 97 S.Ct. 634, 50 L.Ed. 2d 621 (1976) a case involving 49 U.S.C. §20(a), the predecessor to §11301. However, *Gabriel* is distinguishable in that it involved a recapitalization that facilitated the carrier's ability to obtain financing and was the result of extensive arm's-length bargaining and a court approved settlement. *Gabriel* also involved an "exhaustive report" by the Commission and an analysis by independent advisers specializing in transportation finance, neither of which factors are present here.

In this case, the purported business purposes to be served, as expressed by the Railroad and approval by the Commission, were illusory. To accept the proposition that the elimination of the minority interests in this case could, in and of itself, constitute a legitimate corporate purpose would mean that any and every freezeout, no matter how improper the private motives of the majority, would be proper. Prior to the decision of the court below, this was not, and should not be permitted to remain federal law.

Neither the Railroad nor the Commission could cite any previous instance in which the Commission permitted the controlling stockholder of a carrier to cash out minority interests solely for the convenience of the majority, over the objections of the minority, and without demonstrating how the corporation as a whole derived any substantial benefit as a consequence.

Furthermore, no policy reason exists for permitting the minority, in carriers in which the public has an interest, to be cashed out at the whim of the majority, even though a substantial majority of state and federal courts which have considered such actions in the context of state corporation laws have disapproved of such practices unless expressly permitted by state statute. The court below erred absolutely in stating (at A-21) that petitioner proposes that the ICC adopt "**** a federal standard of fiduciary duty owed by majority shareholders to minority shareholders, which would be more stringent than available under state law." (As stated above, the standards which we propose accord with those of the majority of courts and legal commentators which have ruled on or dismissed these issues in a state law context.)

The court below also erred in stating (at A-19, fn 6) that *Coleman, supra*, held that, while Delaware law requires a business purpose for cashing out minority interests, such purpose may relate solely to the interest of the majority shareholder. *Coleman* held directly to the con-

trary; however, in *Coleman*, the minority shareholder involved had acquired his stock pursuant to a contract which expressly provided for the repurchase of his stock for cash in the event he left the employ of the closely held corporation whose securities were involved.

The court below also implied (at A-19) that the law of Missouri, in which the Railroad was incorporated, permits the majority to cash out a minority, and states (at A-22) that petitioner does not question the propriety of the Commission's *application* of Missouri law. These assertions, too, are incorrect. There is no Missouri decision which sanctions the cash-out of a minority at the whim of a majority stockholder. Missouri statutes do permit short form mergers (MO. ANN. STAT. §351.447 Vernon)) and redemption of fractional shares (MO. ANN. STAT. §351.390 (Vernon)). However, if the Railroad had attempted to effect this freeze-out through a short form merger, rather than through a reverse stock split, the minority would have had the right, under the Missouri statutes, to a judicial determination of the "fair value" of their stock interests in the Railroad — *and in terms of an appropriate percentage of the worth of the Railroad as a whole*. The minority would also have had the right, in that connection, to have the reviewing court consider not only such conventional factors as asset value, earnings, and dividends, but every other relevant fact and circumstances which might enter into the value of the corporate property and reflect itself in the worth of corporate stock, *including what might be offered for the Railroad or its assets by another railroad*. *Dreiseszun v. FLM Industries, Inc.*, 577 S.W.2d 902 (Mo. App. 1979); *Phelps v. Watson-Stillman Co.*, 293 S.W.2d 429, 365 Mo. 1124 (1956). These are the very factors which, admittedly, the expert on whom the Railroad relied to jus-

tify the terms of the present freeze-out gave no consideration whatever.⁹

The conventional purpose of a reverse stock split of publicly held stock is to increase the market value of individual shares which, before the split, are so low that they attract little or no investor interest. What the Railroad, with the Commission's and now the court below's approval, seeks is to use a reverse stock split to eliminate a minority interest because, under Missouri law, a resort to the conventional method of cashing out a minority, i.e., a short form merger, would have required consideration of valuation factors, such as the minority's interest in the value of the railroad as a whole to a potential merger partner, which the Railroad desired to ignore. The Railroad wanted consideration given only to factors such as the prices at which the Railroad's few securities were publicly traded in the marketplace, where their price had already been depressed by actions of the majority shareholder in withholding and/or arbitrarily limiting dividends in the four years preceding the proposed cash-out and, just previous to that, making a tender for minority shares at a price substantially less than the shares were actually worth at a time, but after dividends had been suspended for five or six years.

A Missouri court might well have concluded that, under such circumstances, the use of a reverse stock split, rather than a short firm merger, to effect the cash-out was a fraud prohibited by Missouri law.

9. The ICC also considers factors such as these in determining the proper price to be paid in the event of a merger. *Illinois Central Gulf Railroad Co.*, 338 I.C.C. 805, 816 (1971); *Seaboard Airline R. Co. - Merger - Atlantic Coastline*, 320 I.C.C. 122, 190 (1963).

2. By The Order Complained Of, The Court Below Held That, In A Context Where A Crucial Question Should Be The Bona Fides Of The Professed Motives Of A Carrier's Parent, The Commission May Approve A Freeze-out While Denying The Minority The Right To Both Essential Discovery And A Hearing.

At the very least, the present case involves bona fide questions with respect to the justification, factually, for the freeze-out, as well as the proper prices to be paid for the minority interests. Notwithstanding, the Commission declined to permit petitioner to conduct *any* discovery from the Railroad, by means of depositions or production of relevant documents, with respect to these issues. The Commission also denied petitioner an oral hearing.

The regulation (49 C.F.R. §1100.43) by which the Commission purported to justify such arbitrary action specifically states that an oral hearing may be denied only "**** if it appears that substantially all the important issues of material fact may be resolved by means of written materials". Also, whenever the constitutionality of the so-called "modified hearing" procedure used here has been upheld, courts have specifically pointed to the parties' rights to establish by discovery that, in fact, material facts are or are not in dispute. *Crete Carrier Corporation v. U.S.*, 577 F.2d 49 (8th Cir. 1979); *Yellow Forwarding Company v. I.C.C.*, 369 F.Supp. 1040, 1048 (D. Kan. 1973); *National Trailer Convoy, Inc. v. U.S.*, 293 F.Supp. 634 (N.D. Okla. 1968); *Allied Van Lines Co. v. U.S.*, 303 F.Supp. 742, 748 (C.D. Cal. 1969).

In its Opinion (at A-24-25), the court below implied that the discovery which petitioner sought to conduct before the Commission was unduly burdensome. However, if petitioner had been questioning the propriety of the proposed transaction in the context of a lawsuit, rather than in the context of an administrative proceeding, i.e. the forum to which petitioner was relegated by

statute, no one would question the relevance or the propriety of any of the discovery sought, and denied, here. The Court can readily determine the validity of this assertion by reviewing petitioner's discovery requests, which are set forth in detail in Appendix "D". (The truncated summary in the Opinion of the court below (at A-24-25) does not present clearly what the record actually shows.)

CONCLUSION

The decision of the Interstate Commerce Commission which we have requested this Court to review reflects, plainly and clearly, the Commission's determination to concern itself only with the interests of railroads, and not with the interests of individual stockholders with small minority interests in those railroads, in freeze-out situations. By its arbitrary denial of discovery and an oral hearing, as well as by its ultimate decision, the Commission clearly demonstrated its determination to prevent individual minority shareholders from requiring the Commission to decide, with fair regard to due process, property issues of substantial significance to those individual shareholders — issues of the same type which federal and state courts invariably refrain from deciding until the litigants have been afforded a fair opportunity for discovery, and a hearing, too, unless it clearly appears that no basic facts are disputed.

There is no statutory or policy reason whatever why, in a parallel context, minority shareholders of railroads and other ICC regulated carriers should be relegated to a status significantly lower than that of minority shareholders of other publicly held corporations.

The court below failed to take appropriate action in this connection. Unless this Court grants certiorari, two egregious and highly significant precedents in practice

before the Interstate Commerce Commission will become "the law of the land."

Respectfully submitted,

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APPENDIX A

INTERSTATE COMMERCE COMMISSION

DECISION

Finance Docket No. 29594

KANSAS CITY SOUTHERN RAILWAY COMPANY — STOCK

Decided: February 2, 1982

On February 26, 1981, Kansas City Southern Railway Company (KCSR), filed an application for authority under 49 U.S.C. 11301 to reissue its preferred and common stock pursuant to a reverse stock split. KCSR will exchange (1) one share of preferred stock for each 7,000 shares of preferred stock outstanding, and (2) one share of common stock for each 2,000 shares of common stock outstanding. Non-converted shares will be paid in cash in the amount of \$30 per share of preferred stock and \$210 per share of common stock.

Protests to the application were filed by two minority shareholders, Frank J. Laird, who holds 1,069 shares of common stock, and Paul E. Rapp, who owns 275 shares of preferred stock. The proceeding was set for modified procedure by decision served May 15, 1981. Discovery was authorized by our decision of July 21, 1981. A verified statement has been filed by protestant Laird and applicant has replied.

Preliminary Matters

Applicant has questioned the admissibility of the statement filed by protestant Paul E. Rapp dated June 29, 1981, on the basis of non-compliance with the Commission's rules of practice regarding the filing of pleadings in a proceeding handled under the modified procedure. The document filed by Rapp has not been verified as required by Rule 48 (49 CFR 1100.48). In the circumstances the pleading will be rejected. Mr. Rapp's ar-

guments do not differ in substance from protestant Laird's statement; thus, his point of view will be represented in the proceedings.

On November 5, 1981 Mr. John Dunn filed a letter-petition objecting to the stock transaction. The protest was filed substantially after the time authorized and is not verified. In the circumstances we will reject the petition as not conforming with the Commission's rules of practice. Mr. Dunn's interest is similar to the position presented by Mr. Laird and therefore his view will also be represented in this proceeding.

On October 13, 1981, Protestant Laird filed a petition under 49 CFR §1100.49 seeking permission to file a counter-reply which was included with the petition. Applicant has submitted a response. Protestant has submitted the petition in order to correct certain alleged errors in the applicant's prior pleadings. The applicant does not oppose the reply since it is of the opinion that the pleading does not introduce new issues or evidence nor does it add to the substance of the record. Rule 49 provides the Commission with the discretion to allow the acceptance of additional pleadings. The protestant's counter-reply does not represent an introduction of new evidence or an attempt to delay the resolution of the transaction before us. Under these circumstances we will accept the counter-reply into the record.

Protestant Laird has requested an oral hearing under 49 CFR §1100.51. We find that the record is adequate and sufficient to resolve the issues presented. The request for oral hearing is denied.

Proposed Transaction

KCSR is a corporation organized and existing under the laws of the State of Missouri. Applicant and other railroads it controls through stock ownership operate about 1,600 miles of road in Missouri, Kansas, Oklahoma, Arkansas, Louisiana and Texas. System revenue

for calendar year 1980 amounted to \$277 million with a net income of approximately \$23.5 million.

KCSR is authorized to issue 1,266,000 shares of common stock of which 1,020,000 shares are presently outstanding. When the exchange is authorized there will be 507 shares of common stock issued and outstanding. No fractional shares will be issued. The common stock is without par value and has no stated value.

Applicant is authorized to issue 420,000 shares of preferred stock all of which are issued and outstanding. The stock will have a par value of \$350,000. After the conversion there will be 60 shares of preferred stock issued and outstanding. The total capital stock value of the reissued common and preferred stock will be \$56,504,000. Both classes of stock will be entitled to one vote per share on all matters except for cumulative voting for election of directors which is required by Missouri corporation law. The holders of preferred stock shall be entitled to receive dividends from net earnings not exceeding the rate of four percent per annum before dividends are declared or paid to common stockholders. Preferred stock dividends are not cumulative. Both classes of stock have no conversion privileges, are non-assessable, and are not callable. Upon liquidation of the corporation preferred stockholders are entitled to the par value before the payment to holders of common stock.

Under the proposed reissuance plan applicant will compensate minority stockholders in cash at the rate of \$30 per share of preferred stock and \$210 per share of common stock for shares not exchangeable into the reissued shares. Applicant's parent, Kansas City Southern Industries, Inc. (KCSI) and its subsidiaries own or control more than 98 percent of the preferred stock, totaling 412,186 shares and more than 99 percent of the common stock, totaling 1,018,052 shares. The remaining 7,418 shares of preferred stock are held by approximately 70 persons and the remaining 1,948 shares of common stock are held by approximately 28 persons.

In order to determine a fair and equitable exchange price KCSR used the services of the investment banking firm of Kidder, Peabody & Co. to evaluate applicant's stock. Kidder, Peabody as part of its operations is regularly engaged in the valuation of businesses and their securities. KCSR was compared with other railroads having publicly traded common and preferred stocks. Financial and other material which was publicly available or furnished by management was also reviewed in performing the evaluation. In addition they considered the equity market conditions, size of minority holdings and the nature of the market for KCSR stocks in arriving at the fair value. Kidder, Peabody determined that the fair value per share of the preferred stock is between \$18 and \$22 and the common stock is between \$170 and \$200.

In determining the estimated value for common stock Kidder, Peabody used certain valuation methods predicated on KCSR continuing as an ongoing business concern. These methods were the equity valuation model, the discounted cash flow method and the capitalized earnings method. The equity valuation model examines the future stream of dividend payments an owner of common stock might reasonably expect to receive, discounted to present value. Based on a \$10 current dividend rate with a 12 percent growth factor the equity valuation resulted in a value per share of \$105. The discounted cash flow method uses applicant's forecasts to arrive at the present value of "free cash" available from operations after meeting current and future capital needs. This method resulted in a value of about \$200 per share for the common stock. In the capitalized earnings method or price earnings ratio, the ratios of twelve railroad stocks were examined including KCSI. The average of the twelve stocks was 8.1, and the applicant's parent company was 7.7. Applying both ratios to KCSR's estimated earnings resulted in a per share value of \$176 and \$185, respectively.

To determine the fair value of the preferred stock Kidder, Peabody compared the stocks of comparably rated railroad stocks. A range of dividend yields for applicant's preferred was determined. Using the formula of dividend yields equals dividend rate divided by price, a fair value of between \$18 and \$22 per share was then determined.

The proposed transaction was authorized by the Board of Directors on November 21, 1980. The amount of compensations was set at \$30 per share of preferred stock and \$210 per share of common stock after taking into consideration the Kidder, Peabody evaluation. The proposed reissue was approved by shareholders at a special meeting held on January 14, 1981. Only protestant Laird voted against the proposed reverse stock split.

Issues Presented

Applicant contends that the proposed transaction will reduce costs and facilitate mergers and thus is for a valid business purpose within the provisions of 49 U.S.C. 11301(d)(1). In addition, the proposed cash payments to minority stockholders are said to be fair and equitable. Applicant also states that the transaction complies with applicable law.

Protestant Laird argues that the transaction is a ruse merely to eliminate minority interests without adequate compensation. The protestant contends that there is no valid business purpose for several reasons. The cost of maintaining minority stockholder records is insignificant. There has been no record of interference with management and the argument of a possible conflict with the holding company management is a smoke-screen. Protestant states that since there is no valid business reason the transaction is not in compliance with applicable law.

Discussion and Conclusions

We agree with the applicant and find that the transaction should be authorized. This authorization is permissive and not obligatory.

1. Valid business purpose

The Commission is authorized to approve an application for issuance of securities if we find that the issuance "is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose" (49 U.S.C. 11301(d)(1)(A)). Elimination of the cost of maintaining a stockholder support system for 28 holders of common stock representing two-tenths of 1 percent of common stock outstanding and for 70 holders of preferred stock who own less than 2 percent of such shares is a benefit which will inure to the applicant and thus is a reasonable corporate purpose. In addition, avoidance of a possible conflict of interest between the parent and the minority stockholder is also a proper corporate purpose. The fact that such conflict has not occurred previously does not negate this purpose.

2. Compensation of Minority Interest

This Commission must consider whether the proposal is just and reasonable to all stockholders including minority stockholders since the rights of stockholders are a part of the public interest. See *Schwabacker v. United States*, 334 U.S. 182 (1948). However, the setting of a specific price is essentially the responsibility of management subject to approval by its stockholders, pursuant to the provisions of the corporate charter. In order to approve the reasonableness of the conversion plan we must examine the adequacy of the compensation being offered for those shares not being converted. The applicant has employed the investment banking firm of Kidder, Peabody & Co. to develop a fair value for the stock not converted. In arriving at the value Kidder Peabody has used several standard valuation methods in-

cluding the capitalization of earnings method which resulted in a per share value range for common stock of between \$170 and \$200 and for preferred stock of between \$18 and \$22 per share. We have frequently considered a railroad's earning power as the primary determinant of value and that anticipated future earnings have an important bearing on value. See *Seaboard Air Line R. Co.—Merger—Atlantic Coast Line*, 320 I.C.C. 122, 193 (1963) and *Schwabacher v. United States*, *supra*. Current and historic earnings may properly be considered, and with varying degrees of emphasis future earnings may be a reliable criterion of current worth. *Consolidated Rock Co. v. DuBois*, 312 U.S. 510, 526 (1941). Thus, the capitalization of earnings method used here to determine present and prospective worth is a reasonably conventional and generally accepted method for determining the value of stock. *Missouri Pac. R. Co., Securities*, 347 I.C.C. 377 (1973). The Board of Director's increase of the proposed compensation over the values determined by Kidder, Peabody & Co. does not negate the reasonableness of the compensation to be paid for the non-converted shares. In our opinion the proposed plan is not contrary to the public interest. Pursuant to our authorization for discovery protestant was able to examine records and documents used to evaluate the applicant's operations and develop a fair compensation. Other than general comments that the value is inadequate, protestant has not submitted expert authority computing his own value or refuting that of applicant's expert. Protestant's mere statements are insufficient for us to ignore the professional opinion submitted by applicant. No fraud or gross unfairness is being imposed on the minority interests by their elimination. Protestant has represented "book value" as a fair compensation value. This valuation is not a proper measure of the fair value of stock. The proper measure is earnings and the capitalized method is the acceptance one. See *Gabriel v. U.S.*, 116 F. Supp. 810 D.N.T. 1976.

3. Compliance with applicable law

The Commission's authority to approve the issuance of railroad securities is exclusive and no other approval is required unless a public issuance of securities is involved in which case authorization from the Securities and Exchange Commission may be necessary. See 49 U.S.C. 11301(b)(1). This jurisdiction is not discretionary. See *Schwabacker, supra*. In order to determine whether the transaction is allowable under the state law of incorporation we must address ourselves to the Missouri corporate law. The applicant avers that it has followed state law which allows for reverse splits and elimination of fractions. Protestant does not provide evidence to refute this contention. Protestant refers to Delaware law to support his argument. He does not show how such law is applicable to a Missouri corporation. Under the circumstances we conclude that the transaction is in compliance with applicable law. Our authorization herein does not preclude rights, if any, which protestants may have under the corporate law of the State of Missouri.

We find:

The proposed issuance of 507 shares of common stock and 60 shares of preferred stock by Kansas City Southern Railway Company to implement the reverse stock split described above (a) is for a lawful object within the corporate purposes of applicant and reasonably appropriate for those purposes; (b) is compatible with the public interest; (c) is appropriate for and consistent with the proper performance by applicant of service to the public as a common carrier; (d) will not impair the financial ability of applicant to provide the service; and (e) will not constitute a major Federal action significantly affecting the quality of the human environment or the conservation of energy resources.

It is ordered:

1. The pleading filed by protestant Paul E. Rapp dated June 29, 1981 is rejected.

2. The letter-petition filed as a protest by John Dunn on November 5, 1981 is rejected.

3. The counter-reply filed by protestant Frank J. Laird and the answer by applicant are accepted into the record.

4. The request for oral hearing is denied.

5. Kansas City Southern Railway Company is authorized to issue 507 shares of no-par common stock and 60 shares of preferred stock having a par value of \$350,000, upon the terms and for the purposes stated above.

6. Except as herein authorized, said stock shall not be sold, pledged, repledged, or otherwise disposed of by applicant unless or until so ordered or approved by the Commission.

7. Applicant shall submit for consideration of the Commission three copies of the journal entries required to record the transaction. Journal entries should be sent to Bureau of Accounts, Interstate Commerce Commission, Room 6113, Washington DC 20423.

8. Kansas City Southern Railway Company shall report concerning the matters involved in this proceeding in conformity with 49 CFR §1115.6.

9. Pursuant to 49 U.S.C. §11301(d) (1) the Commission may modify the terms of this decision.

10. Nothing in this decision shall be construed to imply any guaranty or obligation as to said stock, or dividends thereon, on the part of the United States.

11. This decision shall be effective 30 days after date of service.

By the Commission. Chairman Taylor, Vice-Chairman Gilliam, Commissioners Gresham and Clapp.

JAMES H. BAYNE

Acting Secretary

(SEAL)

A-10

APPENDIX B

**UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

No. 82-3076

FRANK J. LAIRD, *Petitioner*

v.

**INTERSTATE COMMERCE COMMISSION and
UNITED STATES OF AMERICA,**
Respondents

**THE KANSAS CITY
SOUTHERN RAILWAY COMPANY,**
Intervenor

**PETITION FOR REVIEW
INTERSTATE COMMERCE COMMISSION**

Argued September 28, 1982

**Before: ALDISERT and HIGGINBOTHAM, *Circuit Judges*,
and MEANOR, *District Judge*.***

(Filed October 14, 1982)

**William F. Baxter, Esq.
Assistant Attorney General**

**John J. Powers, III, Esq.
Kenneth P. Kolson, Esq.
*Attorneys***

**Department of Justice
Washington, D.C. 20530**

* Honorable H. Curtis Meanor, of the United States District Court
for the District of New Jersey, sitting by designation.

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OPINION OF THE COURT

ALDISERT, *Circuit Judge*.

This petition, filed by a protesting minority shareholder, asks us to review the Interstate Commerce Commission's approval of a transaction of the Kansas City Southern Railway Company involving a reverse stock split coupled with the purchase of any resulting fractional shares. We are required to decide: whether there is substantial evidence in the record as a whole to support the Commission's findings that the transaction

was for a proper corporate purpose and that adequate compensation was offered for the fractional shares; whether the Commission selected the proper legal precepts in determining that the transaction was for a lawful corporate object; and whether the Commission abused its discretion in denying Petitioner's requests for extensive discovery and an oral hearing. Because we conclude that the Commission neither erred nor abused its discretion, we will deny the petition.

I.

The Kansas City Southern Railway Company, a Missouri corporation and Intervenor here, had 1,440,000 shares of stock outstanding; of these, 420,000 were preferred shares and 1,020,000 were common. Kansas City Southern Industries, Inc., the railway company's parent company, owned or controlled 98% of the preferred stock and 99% of common. Seventy minority shareholders held the remaining 7,418 preferred shares and twenty-eight minority shareholders held the remaining 1,948 common shares. On February 26, 1981, the railway company filed an application with the ICC, pursuant to 49 U.S.C. § 11301, for authority to reissue its securities to effect a reverse stock split.¹ The proposal would allow the railway company to issue one share of new preferred stock for every 7,000 shares of old preferred and one share of new common stock for every 2,000 shares of old common. The plan also called for the purchase, by the railway company, of any resulting fractional shares at \$30 per share for the preferred and \$210 per share for the common. It is not disputed that this transaction would eliminate all minority shareholders.

1. Section 11301(b)(1) provides:

[T]he Commission has exclusive jurisdiction to approve the issuance of securities by a carrier A carrier may not issue securities . . . without the approval of the Commission.

Petitioner Frank J. Laird, a Pennsylvania resident, owned 1,069 shares of the railway company's common stock and opposed ICC approval of the transaction. He claimed that the evidence was insufficient to support a finding either that the transaction was for a proper "corporate purpose" or that the proposed compensation for fractional shares was adequate (and thus the transaction was not "reasonably appropriate" for that corporate purpose); that the transaction was not for a "lawful object"; and that the Commission abused its discretion in denying his motions for extensive discovery and an oral hearing. Laird argues these same points on appeal. The first two claims relate to the manner in which the Commission fulfilled its statutory duty under 49 U.S.C. §11301.² The third refers to the manner in which the Commission applied its own procedural rules.

On February 8, 1982, after determining that the transaction met federal statutory standards and was legal under the corporation law of Missouri, and after granting Laird limited discovery but denying his request for an oral hearing, the ICC approved the transaction. Laird then filed this petition for review.

2. Under 49 U.S.C. §11301(d)(1)(A)-(D), the Commission may approve such an application only when it finds that the issuance

(A) is for a lawful object within the corporate purpose of the carrier and reasonably appropriate for that purpose;

(B) is compatible with the public interest;

(C) is appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier; and

(D) will not impair the financial ability of the carrier to provide the service.

Here the Commission specifically found that all of these statutory requirements were satisfied.

This court has jurisdiction under 28 U.S.C. §2342(5) to review the Commission's order.⁵ We have permitted the railway company to intervene.

II.

A.

Laird first asserts that there was insufficient evidence to support the Commission's findings either that the stock split was for a proper corporate purpose of the carrier or that the compensation offered for fractional shares was adequate. In considering the sufficiency of evidence in support of an agency ruling our review is limited. The Commission's order will be upheld unless it is found to be arbitrary, capricious, an abuse of discretion, or unsupported by substantial evidence. 5 U.S.C. §706(2) (A), (E); see *Bowman Transportation, Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 285 (1974). Further, in reviewing an ICC order, this court will not reweigh the evidence presented before the Commission. It is for the Commission, as the trier of fact, to weigh the evidence and draw the appropriate inferences therefrom. *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, ____ U.S. ____ (50 U.S.L.W. 4592, 4596, June

3. Section 2342(5) provides:

The court of appeals has exclusive jurisdiction to enjoin, set aside, suspend (in whole or in part), or to determine the validity of —

(5) all rules, regulations, or final orders of the Interstate Commerce Commission

In addition, Petitioner has complied with the provisions of 28 U.S.C. §§2343 ("venue of a proceeding under this chapter is in the judicial circuit in which the petitioner resides . . .") and 2344 ("[a]ny party aggrieved by the final order [of the ICC] may, within 60 days after its entry, file a petition to review the order in the court of appeals wherein venue lies").

1, 1982); *Ralston Purina v. Louisville & N.R.R.*, 426 U.S. 476 (1976); *Universal Minerals, Inc. v. C. A. Hughes & Co.*, 669 F.2d 98, 103 (3d Cir. 1981). Our task is merely to determine if there is substantial evidence in the record to support the basic and inferred facts found by the administrative agency. Substantial evidence is "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion."⁴ *Consolo v. Federal Maritime Commission*, 383 U.S. 607, 620 (1966) (quoting *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938)).

1.

Arguing to the ICC that the proposed transaction was for a proper corporate purpose, the railway company stated that the elimination of minority shareholders would (1) obviate the expense of maintaining the capability of communicating with, reporting to, keeping records for, transferring stock of, and otherwise continu-

4. "Substantial evidence is more than a mere scintilla. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion." *Consolidated Edison Co. v. NLRB*, 305 U.S. 197, 229 (1938); substantial evidence means that "affording a substantial basis of fact from which the fact in issue can be reasonably inferred. . . . [I]t must be enough to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury." *NLRB v. Columbian Enameling & Stamping Co.*, 306 U.S. 292, 299-300 (1939). Under the substantial evidence standard, a reviewing court does not reweigh the evidence, resolve testimonial conflicts, or "displace the Board's choice between two fairly conflicting views, even though the court could justifiably have made a different choice had the matter been before it *de novo*." *Universal Camera Corp. v. NLRB*, 340 U.S. 474, 488 (1951). Thus a reviewing court does not reweigh the evidence or reject reasonable agency inferences simply because other inferences might also have been reasonably drawn. See *NLRB v. Walton Mfg. Co.*, 369 U.S. 404, 405 (1962); *NLRB v. Lewisburg Chair & Furniture Co.*, 230 F.2d 155, 157 (3d Cir. 1956).

ing to maintain a support system for the small number of minority shareholders; (2) eliminate the possibility of any conflicts of interest between minority shareholders and the parent corporation; and (3) facilitate potential mergers or acquisitions involving the railway company as a target. As he contended to the ICC, Laird now objects that the railway company did not prove either that the freezeout of minority shareholders would effectuate anything more than minimal savings or that there had been any concrete evidence of a conflict of interest in the past. We find these objections meritless.

The railway company offered evidence to the Commission to support its contention that the transaction was for a proper corporate purpose. This evidence, consisting of the three arguments recited above, while not so substantial as to compel the ICC finding of proper corporate purpose, is sufficiently substantial to support that finding. Moreover, as the railway company points out, Laird does not now contest the accuracy of that evidence; his only contention is that it was, in his opinion, insufficient. Further, we can find no authority establishing either a requirement that elimination of an unnecessary expense (*i.e.*, the minority shareholder support system) must effect anything more than minimal corporate savings in order to be deemed a proper corporate purpose, or that the avoidance of potential, as distinguished from actual, conflicts of interest is insufficient to be deemed a proper corporate purpose under §11301.

We hold, therefore, that there is substantial evidence in the record as a whole to support the ICC findings that the reverse stock split was for a proper "corporate purpose" of the railway company.

2.

Laird also argues that even were the transaction for a proper corporate purpose, the evidence to support a finding that it was "reasonably appropriate" for that pur-

pose was insufficient because the compensation offered for the fractional shares was inadequate. The compensation figures used by the railway company were based on a valuation report prepared for it by the investment banking firm of Kidder, Peabody & Co. Laird attacks this report on several grounds: (1) that the report was cursory and represented only a minimal undertaking, accomplished for only \$5,000; (2) that Kidder, Peabody was biased in favor of the railway company because it had recently done work for the parent corporation; and (3) that instead of using the valuation methodologies it chose, Kidder, Peabody should have valued the railway company as a "going concern." We also find no merit in these objections.

The charges that the report was cursory and that Kidder, Peabody was biased are both groundless. First, Kidder, Peabody was able to prepare the report for only \$5,000 precisely because it had done prior work for the parent corporation and was familiar with the operations of the railway company. Also, a report such as this, which fully explains the basis for its recommendations, can be judged on its own merits and thereby withstand an allegation of bias. Further, the charge that the report should have relied on a different valuation methodology ignores what Kidder, Peabody actually did. Kidder, Peabody used several standard valuation methods, including capitalization of earnings, and recommended a per share value range of \$170 to \$200 per share for the common stock and of \$18 to \$22 per share for the preferred stock. The railway company's board of directors then increased these amounts to \$210 for common and \$30 for preferred. The Commission found that both the Kidder, Peabody recommendations and the somewhat more generous board of directors offers were reasonable. Also, because courts have recognized that capitalized earnings is a proper method of stock valuation, *Schwabacher v. United States*, 334 U.S. 182 (1948), *Gabriel v. United States*, 416 F. Supp. 810 (D.N.J.), *aff'd mem.*, 429 U.S.

1011 (1976), the Commission determined that the valuation method used by Kidder, Peabody was acceptable. Further, as stated by the ICC in its final order "[o]ther than general comments that the value is inadequate, protestant has not submitted expert authority computing his own value or refuting that of applicant's expert. Protestant's mere statements are insufficient for us to ignore the professional opinion submitted by applicant." Petitioner's Appendix at 349. Therefore, finding both the methodology employed by Kidder, Peabody to be acceptable and the valuation reasonable, and noting that Laird failed to submit any expert testimony to rebut the evidence in support of either finding, the Commission concluded that the proposed compensation was just and adequate.

As noted above our inquiry in a petition for review of a decision by an administrative agency is narrow. We hold that there is substantial evidence to support the Commission's findings that the compensation offered for fractional shares was adequate and that the transaction was "reasonably appropriate" for a proper corporate purpose.

B.

Petitioner next contends that the reverse stock split as proposed by the railway company is illegal and that the ICC's determination that the transaction was allowable under Missouri corporation law was error. To support these contentions Petitioner asserts in his brief before this court that, although he could find "no case decided under 49 U.S.C. §11301 nor any Missouri decision directly on point," the "majority and enlightened view" holds that "a reverse stock split whose sole purpose is the elimination of the minority shareholders is not lawful." As authority, Petitioner cites several decisions construing Pennsylvania and Delaware corporation law, including our decisions *Dower v. Mosser Industries, Inc.*,

648 F.2d 183 (3d Cir. 1981) (Pennsylvania law) and *Coleman v. Taub*, 638 F.2d 628 (3d Cir. 1981) (Delaware law).

The Commission and the railway company respond that because the railway company is a Missouri corporation, the ICC properly relied on Missouri corporation law in determining that the transaction was legal. Further, they argue that even if the ICC should have considered the decisions construing Pennsylvania and Delaware corporation law cited by Petitioner, those cases do not support Petitioner's contentions.⁵ In *Dower*, for example, after noting that majority shareholders owe a fiduciary duty to minority shareholders, we concluded that the presence of this fiduciary duty "does not prevent a cash out under Pennsylvania law. There must be found a fundamental unfairness before such [a transaction] may be enjoined by the courts."⁶ 648 F.2d at 190. Finally, Respondent and Intervenor argue that even if the Delaware and Pennsylvania decisions did support Petitioner's view, and were appropriate for consideration by the ICC, they would be inapposite here because freezing out the minority interests was not the sole purpose of the subject transaction.

If, in deciding the legality of this transaction, the ICC's choice of law was only between competing legal precepts from state corporation law, then we would

5. Petitioner does not clearly state why the ICC should have considered decisions construing either Pennsylvania or Delaware corporation law. As discussed later, we understand Petitioner to argue that the Pennsylvania and Delaware cases represent a higher level of fiduciary duty than that which exists under Missouri law and that the ICC should have drawn on these decisions in developing a federal standard for application in this case.

6. *Coleman* is somewhat closer to Petitioner's mark. There we construed Delaware law as allowing a cash out of minority interests provided there was a business purpose, but determined that, under Delaware law, a business purpose related solely to the interests of the majority shareholders was sufficient. 638 F.2d at 634.

quickly uphold the Commission's determination on the basis of Respondent's and Intervenor's arguments recited above. We are of the opinion, however, that Petitioner's contentions cut more deeply than that. Although Petitioner's objection to the Commission's use of Missouri law is unclear, he apparently questions the Commission's reliance on any state law in support of its determination and argues that the ICC is obliged to apply a federal standard of corporate responsibility. This contention would normally present two questions: whether the Commission chose the correct legal precept by which to judge the legality of the proposed transaction and, if so, whether it properly applied that precept to the facts. But, as will be discussed later, our analysis need not progress beyond the first question. As to the choice of the proper legal precept our standard of review is plenary. *Consolidated Rail Corp. v. United States*, 619 F.2d 988 (3d Cir. 1980).

In the context of the Interstate Commerce Act, choice of law is a difficult question involving subtle interplay between the doctrine of preemption and the incorporation of state law into federal statutory schemes. For cases within its jurisdiction, the authority of the ICC is "plenary and exclusive and independent of all other state and federal authority." *Schwabacher v. United States*, 334 U.S. 182, 197 (1948). Further, the Supreme Court has stated that, in carrying out its statutory mandate,

the Commission must look for standards . . . only to the Interstate Commerce Act. In matters within its scope it is the supreme law of the land. . . . The Commission likely would not and probably could not be given plenary and exclusive jurisdiction to interpret and apply any state's law. Whatever rights the appellants ask the Commission to assure must be founded on federal, not on state, law.

Id. at 198. In light of *Schwabacher*, the Petitioner here properly questions the Commission's apparent reliance on Missouri corporation law.

The usual rule is that when Congress adopts a federal statutory scheme (*e.g.*, the Interstate Commerce Act) it "normally intends that [the scheme] shall operate uniformly throughout the nation" *Reconstruction Finance Corp. v. Beaver County*, 328 U.S. 204, 209 (1946) (citing *Jerome v. United States*, 318 U.S. 101, 104 (1943)). And when that federal statutory scheme does not indicate which law is to be applied in carrying out its commands (and when reliance on state law could jeopardize the desired uniformity of operation) courts have adopted a federal rule for consistent application. *Id.* at 208-09. Not every statutory scheme requires a uniform federal rule, however, and in a variety of circumstances state law has been relied on, and thereby incorporated into the federal statutory scheme. See, *e.g.*, *Reconstruction Finance Corporation; United States v. Burnison*, 339 U.S. 87 (1950).

The instant petition presents the issue of incorporation of state law in a slightly different light. Here, the normal rule favoring uniformity of consequences through the consistent application of a single set of legal precepts confronts the countervailing reality that there is no general, comprehensive federal corporation law upon which a court or administrative agency can draw. And, although the ICC would be within its power to establish, as Petitioner here proposes, a federal standard of fiduciary duty owed by majority shareholders to minority shareholders, which would be more stringent than available under most state law, recent United States Supreme Court precedent militates strongly against such a move. See *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462 (1977).⁷

7. *Santa Fe* involved the merger of a subsidiary corporation into its parent, Santa Fe, a Delaware corporation. The parent owned

In the instant case, because there is no established body of federal substantive law in an area where federal standards must form the basis of decisions, the ICC chose to rely nominally on state law. In so doing, the Commission impliedly incorporated state law into a federal statutory scheme. Thus, the federal standard for determining the legality of a transaction proposed by a carrier subject to ICC jurisdiction is whether, in the Commission's view, that transaction is for a lawful object under the law of the state of incorporation. Thus viewed, the ICC did as the Petitioner demands, and as it was legally bound to do: it formulated a federal standard to determine the legality of the proposed transaction.

As we read Petitioner's objections, he does not present an alternative argument that, assuming the Commission's *choice* of Missouri law as the controlling federal precept was correct, its *application* of that law to the facts was error. We need not consider, therefore, whether the correctly chosen legal precept was also correctly applied, although in passing we note that the Commission's determination of the transaction's legality under the law of Missouri is ably done.

95% of the subsidiary's shares and, under Delaware corporation law, the merger could be accomplished without the approval of the shareholders of either corporation. As part of the merger, Santa Fe told the subsidiary's minority shareholders that they would be cashed out. Green, a minority shareholder, sued in federal court under §10(b) of the 1934 Securities Exchange Act alleging "fraud" because of undervaluation of the shares. The Supreme Court held that the transaction was neither deceptive nor manipulative and thus did not violate §10(b) of the Securities and Exchange Act of 1934. In so doing the Court refused to create a general federal standard of fraud to govern the fiduciary relationship between majority and minority shareholders in a merger/cash out situation. By analogy, the ICC has correctly refrained from establishing a general federal standard to govern the fiduciary relationship between majority and minority shareholders in a reverse stock split/fractional share purchase situation.

We hold, therefore, that the Commission selected the proper legal precept to determine if the proposed transaction was for a "lawful object."

III.

We now turn to Laird's attack on the ICC procedures. Laird argues that the Commission abused its discretion and wrongfully denied his request for full discovery. As a result, he asserts, he was prevented from establishing that material facts were in dispute and, therefore, the Commission's further denial of his request for an oral hearing was also wrongful and an abuse of discretion. We disagree.

At the onset we note that the formulation of administrative procedures is a matter left to the discretion of the administrative agency. *Vermont Yankee Nuclear Power Corp. v. National Resources Defense Council, Inc.*, 435 U.S. 519, 523-25 (1978). Further, because an administrative agency is not required to hold adversarial hearings as part of its dispute resolution process, *Titusville Cable v. United States*, 404 F.2d 1187, 1192 (3d Cir. 1968), it has considerable latitude as to how, through its procedural rules, it wishes to structure the presentation of evidence prior to resolving a particular issue.

The rules of the ICC allow it to hear disputes using a "modified procedure," when "it appears that substantially all important issues of material fact may be resolved by means of written materials." 49 C.F.R. §1100.43. When the "modified procedure" is used, parties must submit verified statements of fact directly to the ICC, *id.* at §1100.48, and "[u]nless material facts are in dispute, [an] oral hearing will not be held" *Id.* at §1100.51. Also, discovery procedures, such as the taking of depositions or the production of documents, must receive Commission approval and a petition requesting

such approval "must be filed in sufficient time to allow for the filing of replies and for consideration by the Commission without requiring the postponement of any established date . . . for submission of initial statements under modified procedure." *Id.* at §1100.55. Finally, a party requesting discovery must, pursuant to 49 C.F.R. §1100.56, "set forth the facts it expects to establish and the substance it expects to elicit."

The ICC decided that the factual issues could be resolved under the Commission's modified procedures. Laird disagreed. He sought to depose five witnesses and to have the railway company and Kidder, Peabody directed to produce numerous documents. He also requested an oral hearing. The Commission allowed Laird to serve interrogatories on one of the witnesses and ordered Kidder, Peabody to produce the requested documents, but it denied the remainder of his requests.

Laird concedes that the courts have upheld the Commission's authority to handle certain applications through its "modified procedure" rules. See *Crete Carrier Corp. v. United States*, 577 F.2d 49 (8th Cir. 1978), *Subler Transfer, Inc. v. United States*, 396 F. Supp. 762, 765 (S.D. Ohio 1975). Nevertheless, he asserts that in this case the use of these rules prevented him from developing adequately his arguments in opposition to the proposed transaction. Laird failed, however, in both his motions before the ICC and his brief to this court to specify how the denied discovery and oral hearing would have allowed him to develop those arguments. The sheer volume of documents requested indicates more a person in search of an argument than one in search of support for an established position.⁸ The Commission concluded

8. Petitioner requested a multitude of documents from the railway company, including all records relating to transfers of its stock, all records relating to communications with the common and preferred shareholders, all records relating to lost stock certificates, all correspondence relating to communications with, and payments for services rendered by Applicant's stock transfer agent, and all

that the requested production of documents would be excessively burdensome and expensive, and that Laird had failed to demonstrate the relevancy of many of the documents. The Commission stated that, based on the information provided by Laird, it would not authorize a "fishing expedition" into the railway company's books. Considering the breadth of Petitioner's discovery requests and the dearth of justification he provides, we hold that the ICC did not abuse its discretion in reaching this conclusion.

Finally, the ICC is not required to hold an oral hearing unless material facts are in dispute and the verified statements do not provide an adequate basis for the resolution. 49 C.F.R. §1100.43; see *Crete Carrier Corp. v. United States*, 557 F.2d 49, 50 (8th Cir. 1978). Laird, both in his request for oral argument before the Commission and in his petition for review before this court, failed to offer any expert or substantive evidence to dispute the issues of business purpose or adequacy of com-

NOTE — (Continued)

records reflecting any anticipated savings in personnel or overhead costs which would result from the elimination of the railway company's minority shareholders.

In addition, Petitioner requested production of many documents of Kidder, Peabody & Co., including all materials and information provided by the railway company and/or its parent in connection with Kidder, Peabody's attempt to determine the fair value of the minority interests, all communications or correspondence relating to the work actually performed by Kidder, Peabody & Co. in evaluating the interests of the minority shareholders, all records and worksheets reflecting the time spent and compensation received by Kidder, Peabody & Co. in connection with its appraisal or evaluation of minority stock interests, and all records pertaining to any reports sent out to, or studies conducted for any railroad, for purposes of valuation or appraisal in connection with any proposed mergers and/or acquisitions.

For the complete list of all requested documents the reader is directed to the Petitioner's Appendix at 137a-41a.

pensation, or any expert or substantive evidence to support the asserted reasons for the necessity of an oral hearing. His "evidence" consists only of his own statements of personal opinion. We fail to see, therefore, where Laird has placed any material issue sufficiently in dispute to move this court to reverse the Commission's decision and to require an oral hearing before the ICC. Accordingly, we hold that the ICC did not abuse its discretion in determining that disputed issues could be resolved on the basis of the verified statements of the parties and that an oral hearing was unnecessary.

IV.

We have considered all the contentions presented by the petitioner and find not one of them meritorious. The petition for review will be denied.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

APPENDIX C

28 U.S.C. §2321(a) provides in relevant part:

"§2321. Judicial review of Commission's orders and decisions: procedure generally: process

(a) Except as otherwise provided by an Act of Congress, a proceeding to enjoin or suspend, in whole or in part, a rule, regulation, or order of the Interstate Commerce Commission shall be brought in the court of appeals as provided by and in the manner prescribed in chapter 158 of this title."

28 U.S.C. §2342 provides in relevant part:

"§2342. Jurisdiction of courts of appeals.

The court of appeals has exclusive jurisdiction to enjoin, set aside, suspend (in whole or in part), or to determine the validity of —

(5) all rules, regulations, or final orders of the Interstate Commerce Commission made reviewable by section 2321 of this title, and

Jurisdiction is invoked by filing a petition as provided by section 2344 of this title."

28 U.S.C. §2344 provides in relevant part:

"§2344. Review of orders: time: notice: contents of petition: service

On the entry of a final order reviewable under this chapter, the agency shall promptly give notice thereof by service or publication in accordance with its rules. Any party aggrieved by the final order may, within 60 days after its entry, file a petition to review the order in the court of appeals wherein venue lies. The action shall be against the United States.

49 C.F.R. §1100.43 provides:

"§1100.43 Modified procedure, how initiated [Rule 43]

The Commission may, in its discretion, order that a proceeding be heard under modified procedure if it appears that substantially all important issues of material fact may be resolved by means of written materials and that the efficient disposition of the proceeding can be made without oral hearing.

(a) Commission's initiative or by request. Modified procedure (see Rule 5(j)) will be ordered in a proceeding upon the Commission's initiative or upon its approval of a request filed by any party that the modified procedure shall be observed.

(b) Order directing Modified Procedure. An order directing modified procedure will list the names and addresses of the persons who at that time are parties to the proceeding, and direct that they comply with the modified procedure rules. As used in Rules 47, 49 and 51 the term "complainant" shall comprehend the party having the initial duty to establish the truth of the claim or to justify the relief or authorization sought, and the term "defendant" shall comprehend the party controverting the truth of the claim or opposing the relief or authorization sought."

49 C.F.R. §1100.51 provides:

"§1100.51 Modified procedure; hearings [Rule 51]

(a) Request for cross examination or other hearing. If cross examination of any witness is desired the name of the witness and the subject matter of the desired cross examination shall, together with any other request for oral hearing, including the basis therefor, be stated at the end of defendant's statement or complainant's statement in reply as the case may be. Unless material facts

are in dispute, oral hearing will not be held for the sole purpose of cross examination.

(b) Hearing issues limited. The order setting the proceeding for oral hearing, if hearing is deemed necessary, will specify the matters upon which the parties are not in agreement and respecting which oral evidence is to be introduced."

49 C.F.R. §1100.55 provides in relevant part:

"§1100.55 *Discovery [Rule 55]*

(a) In general. Unless otherwise available under the Interstate Commerce Act [49 U.S.C.A. §§1 et seq., 301 et seq., 901 et seq., 1001 et seq., and 1231 et seq.] or other applicable statutes, parties may obtain discovery pursuant to these rules (Rules 55-65, inclusive) regarding any matter, not privileged, which is relevant to the subject matter involved in the pending proceeding (other than those informal proceedings specified in Rules 22, 23, 200, and 225, and proceedings that need not be determined on a record after hearing) provided that, discovery procedures (except for written interrogatories and requests for admissions) may be used only when the Commission, upon its own motion, or upon a verified petition filed by a party, and upon good cause shown, shall have entered an order approving such use. Such petitions, where required, must be filed in sufficient time to allow for the filing of replies and for consideration by the Commission without requiring the postponement of any established date for hearing or for submission of initial statements under modified procedure. Likewise, the use of discovery in those circumstances in which no petition is required must be accomplished without requiring the postponement of any established date for hearing or for submission of initial statements under modified procedure. It is not ground for objection that the information sought will be inad-

missible as evidence if the information sought appears reasonably calculated to lead to the discovery of admissible evidence: provided that Rules 55-65, inclusive, shall not apply to application proceedings handled pursuant to the modified procedure, except that in such proceedings on petition seeking appropriate discovery procedures may be filed."

APPENDIX D
BEFORE THE
INTERSTATE COMMERCE COMMISSION
Washington, D.C.

Finance Docket No. 29,594

In re: Application of the Kansas City Southern
Railway Company

PETITION OF PROTESTER, FRANK J. LAIRD,
SEEKING MODIFICATION OF THE COMMISSION'S
"MODIFIED PROCEDURE DECISION" ORDER TO
PERMIT DISCOVERY PURSUANT TO COMMISSION
RULE OF PRACTICE 55 (49 FR §1100.55)

Protester, Frank J. Laird, comes by his attorneys and petitions the Commission, pursuant to Rule 55 of the General Rules of Practice (49 CFR §1100.55), to modify its "Modified Procedure Decision" Order (Service Date of May 15, 1981) to permit discovery, and for the following reasons:

1. On February 26, 1981, Kansas City Southern Railway Company (hereafter the "Applicant") filed with the Interstate Commerce Commission (the "Commission"), under 49 U.S.C. §11301, an application to re-issue its preferred and common stock pursuant to a reverse stock split (hereafter the "transaction").

2. Under the transaction, applicant proposed, *inter alia*, to exchange one share of common stock for each 2,000 shares of common stock outstanding, and to pay cash in the amount of \$210.00 per share of common stock for fractional shares.

3. Petitioner is Frank J. Laird, an individual residing at West Chester, Pennsylvania, who is, and was at times relevant, the record owner of 1069 shares of common stock of applicant.

4. On March 13, 1981 Petitioner filed a Protest with the Commission, pursuant to 49 CFR §1115.3 and §1100.38, objecting to the transaction on the grounds that it is in fact a fraudulent "freeze-out", is not justified by any valid business reason, and is intended solely to benefit the majority stockholder at the expense of minority shareholders by forcing the latter to surrender their stock at a time when they have no interest in selling, and tendering in exchange cash compensation which the minority believe to be inadequate and unfair.

5. On April 7, 1981 Applicant filed a Reply to the Protest, which submission did not present any concrete information in addition to that set forth in the application itself relative to the business interest to be served by the transaction, the reasons why the majority shareholder should be permitted to compel the minority to surrender their stock for cash, or the adequacy of the cash compensation tendered.

6. The Commission on May 8, 1981, with service date of May 15, 1981, rendered a Modified Procedure Decision (the "Order") by which it directed, *inter alia*, that applicant file a verified statement in support of the application within thirty (30) days of service of the Order, that protestant file a verified statement in opposition to the application within twenty (20) days thereafter (paragraph 4), and that, except for good cause shown, actions on preliminary motions for other relief (i.e., the discovery being requested here) be deferred until all verified statements are filed (paragraph 6).

7. Petitioner-protester, pursuant to Rule 55 (49 CFR §1100.55), seeks modification of paragraphs 4 and 6 of the Order so as to permit petitioner to conduct discovery and to file a supplemental and more complete verified statement in opposition to and in response to the Appli-

cant's Statement of Facts and Argument ("Applicant's Statement") after that discovery has been completed.

8. This relief is requested because Petitioner cannot intelligently and reasonably respond to many of the arguments and averments of the Applicant's Statement because of the lack of factual details set forth in the Applicant's Statement and the two prior filings of the Applicant. For example:

a. Petitioner cannot evaluate applicant's argument that the elimination of expenses of maintaining a stockholder support system constitutes a valid business purpose (Applicant's statement, p.4) in that Petitioner has had no access to information relative to: (1) the methods used by Applicant in the past for communicating with, reporting to, and keeping records for minority shareholders and the cost of maintaining such capability in the future; the frequency of such communications in the past and nature and the volume of the reports and records referred to; (2) the past frequency of, and need for records relative to, the transfer of stock, including materials pertaining to lost stock certifications; (3) expenses involved in otherwise corresponding and dealing with the relatively small number of minority shareholders, and (4) whether it is not a fact that nearly all of the services performed in the recent past in this connection have been performed for the Applicant by parties and personnel performing similar services on behalf of the Applicant's parent.

b. Petitioner cannot properly determine why and to what extent, if at all, Applicant's standing as a potential candidate for merger, consolidation or other acquisition would be enhanced absent the minority shareholders, as averred by Applicant (Applicant's Statement, p. 5). Applicant sets forth no information as to whether, and to what extent, such merger, consolidation or acquisition transactions

may have previously been under consideration by Applicant, and whether or not, and if so where and to what extent, there is any concrete evidence that the existence of this small group of minority shareholders adversely affected either the possibility or terms of any proposed merger, consolidation or acquisition. (Applicant's Statement, p. 5).

c. Petitioner cannot, without knowing the actual history of Applicant's dealings with its parent and minority shareholders in the past, respond to Applicant's assertion that the mere existence of minority interests creates a potential for future conflicts with respect to transactions between Applicant and its parent (Applicant's Statement, p. 5) which conflicts would differ in any material way from the situation presented in any other corporate situation in which the majority of the stock is held by a parent and the minority is held by the public.

d. Petitioner cannot evaluate the Applicant's averments concerning its alleged fairness of the compensation tendered the minority shareholders without discovery as to whether the appraiser would have used different criteria in evaluating the Applicant's assets, and therefore Applicant's overall value, for purpose of a prospective merger and, if so, what additional investigation would have been required and what the value of the present minority interest to the majority shareholder — in terms of Applicant's overall value for purposes of merger — would be.

e. Petitioner cannot evaluate the Applicant's decision to increase the compensation payable to minority common shareholders to \$210.00 per share from the lower stated range of purported fair values (\$170.00 to \$200.00) arrived at by Kidder, Peabody & Co., unless Petitioner is permitted to determine the criteria used by Applicant to make that decision (Applicant's Statement, p. 6).

9. Petitioner cannot realistically respond to the verified Statement of R.S. Trenkman, Vice-President of Kidder-Peabody & Co., unless Petitioner is permitted to depose him to determine the relevant details pertinent to the information provided by Applicant or its parent to, and the methodology utilized by, Kidder-Peabody to arrive at the purported fair value of the stock involved, and in particular petitioner cannot intelligently address the following statements (Trenkman Statement):

(a) The regularity with which Kidder-Peabody & Co. is engaged in the valuation of railroad businesses and/or stock;

(b) The details of, and values utilized, in application of the (1) equity valuation model; (2) the discounted cash flow method and the capitalized earnings methods;

(c) The information and values, book or otherwise, provided by Applicant and/or its parent, and/or utilized by Kidder-Peabody & Co. relating to the underlying business, and in particular the significance of any properties, including track and terminal facilities and/or rolling stock being carried on the books at original cost;

(d) The significance and relevance of the price earnings ratio of other railroad stocks examined in this connection and the identity of those railroad stocks.

10. Petitioner has no means of knowing or evaluating the character and significance of the "financial and other material furnished by Applicant" or the "information provided during discussions with Applicant's management", which were used by Kidder-Peabody & Co. to arrive at the fair value (Trenkman Statement p. 11).

11. Petitioner also has no way of responding to Mr. Trenkman's statement that Kidder-Peabody & Co. relied, without independent verification, on the accuracy, completeness and fairness of all financial and other information which was furnished by Applicant or Appli-

cant's holding company, unless and until petitioner has the opportunity through discovery to determine the nature, extent, accuracy, completeness and fairness of that information.

WHEREFORE, Petitioner pursuant to Rule 55 respectfully asks the Commission to modify its prior Order to permit Petitioner to conduct the below listed discovery prior to the date on which Protestant-Petitioner must file a final and complete verified statement in opposition to the application:

I. Depositions of the following persons:

W.N. Deramus, III — Director of Applicant
Irvine O. Hockaday, Jr. — Director of Applicant
D. L. Graf — Vice President and Chief Financial Officer of Applicant
E.F. James, III — Secretary of Applicant
R.S. Trenkman — Vice President of Kidder, Peabody & Co.; and,

II. Prior to and in anticipation of the listed depositions, production of the following documents of the Applicant and/or its parent for the past five years:

1. All documents and records relating to transfers of the Applicant's stock including but not limited to records reflecting the number and identity of the personnel involved in the process and the number and volume of such transfers;

2. All documents and records relating to communications with, and reports to, the common and preferred shareholders of the Applicant or of its parent as a group or groups;

3. All documents and records relating to lost stock certificates of Applicant's shareholders;

4. All correspondence and memoranda relating to communications with, and payments for services rendered by, Applicant's stock transfer agent;

5. All documents and records, including internal memoranda and/or studies, which reflect any

anticipated savings in personnel or overhead costs, which would result from the elimination of Applicant's minority shareholders;

6. All documents, records, correspondence, minutes and/or internal memoranda relating to any charges or claims of conflict of interest asserted with respect to the Applicant or its parent by any minority shareholder of Applicant;

7. All documents, minutes, transcripts, records, correspondence or other writings relating to the past five annual meetings, or any other scheduled meetings of shareholders of Applicant or of its parent, including all records which reflect the number of shareholders who attended or voted in person or by proxy;

8. All correspondence, memoranda or other documents concerning dealing with any prospective merger, sale of principal assets, or acquisition proposal involving the Applicant including, but not limited to, any documents, correspondence or memoranda which allegedly reflect any concern about any adverse affect on such prospective transactions caused by the existence of Applicant's minority shareholders;

9. All documents, records, correspondence and/or reports, studies or memoranda relating to the value of the Applicant or its properties in the event of a merger, or sale of Applicant's assets in lieu of a merger, and/or the feasibility of any such transaction;

10. All documents, records, correspondence and/or memoranda relating to any actual or prospective sale of any of Applicant's real estate or other non-operating or operating property, including documents which reflect the then current book value or appraisal made in connection with such actual or prospective sale;

11. All documents and records reflecting the date of acquisition, original cost, improvements, replacement cost, current book value and insurance value of Applicant's operating equipment, including rolling stocks;

12. All documents, records, correspondence and/or memoranda relating to the decision and reasons for the decision, to increase the compensation tendered to Applicant's minority shareholders to \$210.00 per share from the \$170.00 to \$200.00 range recommended by Kidder, Peabody & Co.;

13. All documents, records, communications with, and all other materials provided to, Kidder, Peabody & Co. in connection with its valuation of Applicant's minority interests;

14. All Annual Reports and Form 10-K Annual Submissions of the Applicant and its parent;

15. All documents, records and/or memoranda relating to the management fees paid by Applicant to its parent, including work done for Applicant by its parent, and substantiation or justification for the amount of fees paid; and,

16. All documents, records, memoranda, studies, projections and/or other writings which reflect the projected earnings of Applicant for any one or more of the next five years.

III. Prior to and in anticipation of the deposition of Mr. Trenkman, production of documents of Kidder, Peabody & Co. as follows:

1. All documents, correspondence, communications, reports, studies and other materials and information provided by Applicant and/or its parent to Kidder, Peabody & Co. in connection with Kidder, Peabody's attempt to determine the fair value of Applicant's minority interests or minority stock;

2. All communications or correspondence between Applicant, and/or its parent or any person act-

ing on their behalf which describes or relates to the work actually performed by Kidder, Peabody & Co. in evaluating the interests of Applicant's minority shareholders;

3. All records and worksheets reflecting the time spent and compensation received by Kidder, Peabody & Co. in connection with its appraisal or evaluation of minority stock interests in the Applicant and/or its parent;

4. All documents and records pertaining to any reports sent out to, or studies conducted for, any railroad, involving Applicant, for purposes of valuation or appraisal in connection with any proposed mergers and/or acquisitions.

Respectfully submitted,

/s/ Tom P. Monteverde

TOM P. MONTEVERDE

/s/ Albert W. Sheppard, Jr.

ALBERT W. SHEPPARD, JR.

Dated at Philadelphia, PA

June 17, 1981

Of Counsel:

Monteverde, Hemphill, Maschmeyer & Obert

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Philadelphia, PA 19102

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APPENDIX E

INTERSTATE COMMERCE COMMISSION

DECISION

Finance Docket No. 29594

KANSAS CITY SOUTHERN RAILWAY COMPANY — STOCK

DECISION ON DISCOVERY

Decided: July 17, 1981

Kansas City Southern Railway Company (KCS) filed an application for authority to reissue its preferred and common stock pursuant to a reverse stock split. Frank J. Laird and Paul E. Rapp, minority shareholders, filed protests to the application. On May 15, 1981, the proceeding was set for modified procedure.

By motion filed June 19, Laird seeks an order to compel KCS and its parent, Kansas City Southern Industries, Inc. (Industries), to produce certain documents for discovery. Laird also seeks to depose five witnesses. KCS replied to this request on June 26, 1981.

Timeliness of the request — 49 C.F.R. 1100.55(a) describes the Commission's discovery procedure. This rule, in part, provides that discovery petitions "must be filed in sufficient time to allow for the filing of replies and for consideration by the Commission without requiring the postponement of any established date . . . for submission of initial statements under modified procedure." Pursuant to the May 15, modified procedure decision, Laird's verified statement was due on July 6. Laird's discovery petition was filed on June 19. This petition allowed only 17 days for applicant to reply to the petition, the Commission to consider the matter, the parties to complete discovery, and Laird to prepare and submit his statements based on that discovery. We conclude that the request is late filed.

The purpose of the timeliness provision is to prevent parties from using discovery procedures in bad faith attempts to delay resolution of proceedings. Here protes-

tant's request, while late filed, appears to be a good faith attempt to discover pertinent information rather than an attempt merely to delay the proceeding. Since KCS will not be adversely affected by a minor delay for consideration of the request, we will waive the timeliness requirement.

The discovery requests — Initially, Laird seeks the right to depose four officers and directors of KCS. 49 C.F.R. 1100.56(b) provides that a party requesting orders to take deposition shall, *inter alia*, set forth the facts it desires to establish and the substance it wishes to elicit. While Laird has stated the general areas it desires to explore in the discovery proceedings (i.e. fairness of the consideration and business purposes underlying the transaction), Laird has failed to specify the line of questioning he intends to pursue with each of these deponents. He has given us no justification why we should authorize a substantial interruption of the management of KCS rail operations by ordering its directors and officers to submit to unlimited deposition regarding unspecified matters which may or may not be related to the fundamental issues in this proceeding.

Additionally, we do not believe that Laird has shown good cause why KCS and Industries should produce documents requested in association with the depositions described above. Again, Laird failed to demonstrate the relevancy of many of the documents requested. Moreover, he seeks the production of a voluminous amount of information which would be burdensome and expensive for applicant to find and produce.¹ While some of the requested documents may ultimately contain some relevant data bearing on some

1. For example, one of Laird's requests would require KCS to produce all documents, minutes, transcripts, records, correspondence or other writings related to the past five annual meetings, or any other scheduled meetings of shareholders of applicant or of its parent.

issue in this proceeding, we will not authorize a "fishing expedition" into applicant's books based on the information provided.

Laird has requested the right to depose a named officer of Kidder, Peabody & Co. (Kidder), an investment banking firm which appraised the value of the minority interests. Laird has also requested that Kidder produce documents associated with the preparation of this appraisal.² Laird claims that the information is necessary to analyze the firm's qualifications, the information upon which Kidder relied, the methodology used by the firm, and the ultimate conclusions contained in the appraisal.

There appears to be good cause for the production of documents described in paragraphs 1 and 2 of the request directed at Kidder and the examination of the Kidder witness. The information requested in paragraphs 3 and 4 will be denied for the reasons discussed above (i.e. relevancy and burden to respondent).

We believe that the examination of the Kidder witness may be achieved in a less intrusive manner than by

2. Laird's requests include the following:

1. All documents, correspondence, communications, reports, studies and other materials and information provided by Applicant and/or its parent to Kidder, Peabody & Co. in connection with Kidder, Peabody's attempt to determine the fair value of Applicant's minority interests or minority stock;

2. All communications or correspondence between Applicant, and/or its parent or any person acting on their behalf which describes or is related to the work actually performed by Kidder, Peabody & Co. in evaluating the interests of Applicant's minority shareholders;

3. All records and worksheets reflecting the time spent and compensation received by Kidder, Peabody & Co. in connection with its appraisal or evaluation of minority stock interests in the Applicant and/or its parent; and

4. All documents and records pertaining to any reports sent out to, or studies conducted for, any railroad, involving Applicant, for purposes of valuation or appraisal in connection with any proposed mergers and/or acquisitions.

deposition. Accordingly we will order the examination of this witness by interrogatories.³

We order the following discovery:

1. Within 10 days of the service date of this decision, Kidder, Peabody & Co., shall produce the described documents for protestant's inspection.

2. Within 20 days of the service date of this decision, protestant shall serve interrogatories upon R. S. Trentman, Vice President of Kidder, Peabody & Co.

3. R. S. Trentman shall respond to these interrogatories within 30 days of the service date of this decision.

Applicant will be responsible for Kidder, Peabody & Co. and R. S. Trentman's prompt response to these discovery proceedings.

The May 15, 1981, Modified Procedure decision is modified so that protestant shall file its verified statement within 40 days of the service of this order. Applicant's reply is now due within 50 days of this decision.

It is ordered:

1. Laird's petition seeking discovery is granted to the extent described in this decision.

2. Verified statements of applicant and protestant shall be filed within the time periods set by this decision.

3. This decision is effective upon its date of service.

By the Commission, Chairman Taylor, Commissioners Gresham, Clapp, Trantum, and Gilliam.

AGATHA L. MERGENOVICH

Secretary

(SEAL)

3. The ordinary means of obtaining information from a nonparty under the Rules of Practice is the use of depositions and the production of documents in association with depositions under 49 CFR 1100.56. Discovery by written interrogatory (49 CFR 1100.56). Discovery by written interrogatory (49 CFR 1100.60) and requests for the production of documents are not associated with a deposition (49 CFR 1100.64) are directed at parties. In this instance, however, we believe it is proper to permit use of interrogatives to obtain the described information from the nonparty.

A-44

INTERSTATE COMMERCE COMMISSION
Washington, DC 20423

F. D. No. 29594

KANSAS CITY SOUTHERN RAILWAY COMPANY — STOCK
(Decision on Discovery)

July 30, 1981

NOTICE TO THE PARTIES:

A decision of the Commission, decided July 17, 1981, was served on July 21, 1981. The decision, however, contains irrelevant information in footnote three on page 3. Please amend your copies to read as follows:

3. The ordinary means of obtaining information from a nonparty under the Rules of Practice is the use of depositions and the production of documents in association with depositions under 49 CFR 1100.56. Discovery by written interrogatory (49 CFR 1100.60) and requests for the production of documents not associated with a deposition (49 CFR 1100.64) are directed at parties. In this instance, however, we believe it is proper to permit use of interrogatives to obtain the described information from the nonparty.

AGATHA L. MERGENOVICH
Secretary

APPENDIX F

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SN

& COMPANY INCORPORATED

INDEPENDENT SERVICES SINCE 1880

**RESEARCH
STOCK
OF THE
MONTH**

KCSI

Kansas City Southern Industries, Inc.

OFFICES THROUGHOUT THE MIDWEST

MISSOURI St. Louis, Clayton

ILLINOIS Chicago, Chicago Heights, Moline

OKLAHOMA Enid, Lawton, Norman, Oklahoma City
Shawnee, Tulsa

ARKANSAS Little Rock

TENNESSEE Memphis

KANSAS Kansas City, Wichita

WISCONSIN Milwaukee

KENTUCKY Louisville

OHIO Columbus

IOWA Keokuk

COLORADO Denver

MEMBERS NEW YORK, AMERICAN & MIDWEST STOCK EXCHANGES
CHICAGO BOARD OPTIONS EXCHANGE

August 19, 1982

(KSU - NYSE)

Recent Price	Price Range	Earnings Per Share	Price Earnings Ratio	Dividend	Current Yield
28½	1981: 37½-20½	1981 : \$3.95			
	1982: 34½-24½	1982E: \$4.85E	1982E: 5.9X	*\$0.88	3.1%
		1983E: \$6.00E	1983E: 4.8X		

E = Estimated

Fiscal Year Ends December 30

Number of Shares Outstanding (6/30/82): 9,851,000 Shares

% Of Shares Held By Institutions: 26%

* Dividend Currently Is Paid \$0.15 Per Quarter In Cash And \$0.07 Per Quarter In Shares Of
MAPCO Stock

SUMMARY & RECOMMENDATION

The vastly improved position of the railroad industry — financially as well as improved track condition and capital equipment — has enabled the industry to weather the current adverse economic conditions in excellent fashion. The cyclical nature of the industry was obviously reflected in reported earnings for many railroads, but the spectre of bankruptcy has not appeared. In fact, Conrail, the problem child of the rail industry, has steadily improved its overall posture during the recessionary period. We feel that many railroad securities afford attractive investment possibilities.

We continue to believe that Kansas City Southern is a particularly attractive special situation in the railroad group. The fact that this 1700-mile rail system serves the fastest growing industrial area of the nation (the Gulf Coast of Texas and Louisiana) is critical to its above average earnings growth over the past six years, but the single most important earnings consideration has been and will continue to be coal hauling. Kansas City Southern began unit train operations in November, 1976 when it began picking up Western coal originating in Wyoming from Burlington Northern at Kansas City and began delivering to electric utility operating plants in Missouri, Arkansas and Texas. In December, 1981 an initial coal haul to Mossville, Louisiana (Gulf States Utilities) commenced and in early 1982 the final stage of the roads most important coal haul to Welsh, Texas was begun. Coal will continue to be the main contributing factor in the Kansas City Southern earnings picture in the 1980's but the railroad is in an important geographic position in regard to both grain and chemical hauling (Chemical Week estimates that Kansas City Southern is the second leading chemical hauler after Missouri Pacific). *We believe that the consolidation taking place in the railroad industry will ultimately include Kansas City Southern, in view of its strong earnings pattern*

*and since its excellent geographic situation is an important attraction.*¹

Further, Kansas City Southern has important non-rail assets, notably DST which provides record keeping services to the mutual fund industry — growth of money market funds has been an extremely important factor recently. We believe earnings will be in the \$4.75 - \$5.00 per share area in 1982 and could be \$6.00 or better in 1983. We continue to recommend this stock for long-term capital appreciation.

RAILROAD INDUSTRY

The rail industry has been strengthened significantly in the past five years, partially aided by government legislation — the Quad R bill and the Staggers Act — and partially by the energy crisis. The rails are a more energy efficient form of transportation than trucking; secondarily, the increased use of coal by utilities has been a major plus to the rail industry. The single most important long-term factor in the revitalization of the rails has been the Staggers Act which has accomplished two highly significant things: 1. — the railroads have achieved pricing freedom which allows them to freely compete — this factor is currently putting pressure on operating ratios due to the recession but will strengthen the industry significantly over the years. 2. — the railroads are able to depreciate track which was formerly a frozen asset — this obviously increases the longer term financial stability of the rails. The greater flexibility afforded by the various deregulation moves has, of course, heightened the trend toward consolidation of major systems. The proposed acquisition of the Missouri Pacific Railway by the Union Pacific could have a significant competitive impact upon Kansas City Southern since it

1. The emphasis which appears in this Appendix "F" has been added by the authors of this Petition, for the convenience of the Court.

is in direct competition with Missouri Pacific in the Dallas, Shreveport, Baton Rouge and New Orleans area and is in indirect competition in all other areas served by Kansas City Southern. This development would appear to be a negative at first blush but *we believe that the merger of the Missouri Pacific and Union Pacific will create a positive situation for Kansas City Southern stockholders inasmuch as it will, in our opinion, force one of the major systems to acquire this well-situated rail in order to protect its own competitive position vis-a-vis the UP-MOP combination. Kansas City Southern is the most direct route from Kansas City to the Gulf Coast. In our opinion, there are three major rail systems which could improve their competitive position through acquisition of the Kansas City Southern Railway: Burlington Northern, Santa Fe, and Norfolk Southern. Interestingly, two of the three systems already have important connections with Kansas City Southern. Burlington Northern is the originator of the Western Coal which Kansas City Southern picks up in Kansas City. Santa Fe has a cooperative marketing arrangement with Kansas City Southern and the two railroads are moving freight between Dallas and New Orleans in 24 hours and between Oakland, California and New Orleans in five days. We think that further consolidation in the rail industry will occur and a system such as Kansas City Southern, with a strong geographic position and substantial earning power, is a naturally attractive partner.*

Railroad operations are extremely sensitive to general economic conditions and the first half of 1982 was not a particularly good earnings period for the group. However, the financial strength of the industry in general is not severely impaired and its overall position in transportation appears to be significantly strengthened due to both coal movement and intermodal activities. Coal accounts for about 30% of all rail traffic and as seen in the following table was 21.6% above the 1981 first

half when there was a United Mine Workers strike. The increase is not solely because of the strike comparisons as export coal business has been strong during the first half of the year. Grain has been a disappointment in 1982 and the immediate outlook in this area is not particularly strong. Second half activity in the rail area could be somewhat improved over the first half but we believe that it will be 1983 before we witness any significant improvement. The fact that piggyback loadings are showing important increases in a recessionary period indicates to us that the long-term trend in transportation will be intermodal and will strengthen the rail systems in this country. Finally we must mention the improvement in Conrail — a vital factor in the national rail system — which was achieved during a recession period. Improvement in this system — operated by the government — is vital since it originates about 10% of the freight in the nation.

FIRST-QUARTER OPERATING RATIOS

	<u>1982</u>	<u>1981</u>
Atchison, Topeka & Santa Fe	97.45	91.97
Baltimore & Ohio	103.71	93.11
Burlington Northern	94.01	87.76
Chesapeake & Ohio	90.00	87.54
Chicago & North Western	109.51	94.48
Conrail	101.98	104.85
Denver & Rio Grande Western	91.00	84.23
Illinois Central Gulf	107.44	96.26
Kansas City Southern	84.44	83.79
Louisville & Nashville	92.95	90.82
Missouri Pacific	87.12	86.19
Norfolk & Western	73.89	73.17
Seaboard Coast Line	94.72	89.06
Soo Line	88.63	78.21
Southern	83.91	78.55
Southern Pacific	105.35	98.86
Union Pacific	88.01	82.22
Western Pacific	103.93	94.70

Source: "Railway Age"

CARLOADINGS

	Jan. 1 to June 19, 1982	% Change from 1981
Grain	620,202	- 8.4%
Farm Products ex. Grain	106,076	+ 3.8%
Metallic Ores	486,145	- 35.1%
Coal	2,862,609	+ 21.6%*
Crushed Stone, Gravel & Sand	224,205	- 26.9%
Nonmetallic Minerals	253,647	- 25.4%
Grain Mill Products	310,568	- 17.0%
Food & Kindred Products	344,505	- 12.6%
Primary Forest Products	388,778	- 18.2%
Lumber & Wood Prod. ex. Furn.	146,236	- 32.6%
Pulp, Paper & Allied Prod.	417,879	- 16.6%
Chemical & Allied Prod.	578,437	- 16.4%
Petroleum Products	119,341	- 10.7%
Stone, Clay & Glass Prod.	247,084	- 30.0%
Coke	122,721	- 24.8%
Metals & Prod. ex. Coke	267,194	- 35.9%
Motor Vehicles & Equip.	360,088	- 17.9%
Waste & Scrap Materials	215,978	- 33.0%
Forwarder & Ship. Assoc. Traf.	215,474	- 11.4%
All Other Carloads	1,029,457	- 2.3%
LCL Traffic (cars)	5,362	- 14.1%
Total Cars Loaded	9,321,986	- 9.6%
Piggyback**		
Cars Loaded	848,330	+ 8.1%
Trailer Loaded	1,510,493	+ 6.3%

* Increases in coal carloading reflect effects of last year's UMW Strike.

** 24 weeks ended June 12, 1982.

Source: "Railway Age"

RAILROAD OPERATIONS

We expect that 1982 rail revenues will approximate \$345 million and that maintenance-of-way expenditures will be slightly below the 1981 figure of \$62.3 million. The following table indicates the dramatic increase in maintenance expense. This trend has enabled Kansas City Southern to get both its main line and yards into excellent overall condition. We anticipate that maintenance costs will continue at reasonably high levels in

view of the amount of unit coal train traffic which takes its' toll on the rail bed. However, we expect that in future years the maintenance-of-way ratio will begin to decline and affect earnings in a positive manner.

REVENUES AND MAINTENANCE EXPENSES (Millions of \$)

	Railroad Revenues	Maintenance-of-Way Costs	Maintenance-of-Way Ratio
1982	\$345.0E	\$60.0E	17.4% E
1981	\$314.5	\$62.3	19.9%
1980	\$280.5	\$52.6	18.8%
1979	\$224.8	\$41.6	18.5%
1978	\$195.3	\$33.2	17.0%
1977	\$163.4	\$30.1	18.4%
1976	\$147.4	\$28.4	19.3%
1975	\$128.7	\$23.3	18.1%
1974	\$132.2	\$20.4	15.4%
1973	\$121.0	\$16.8	13.9%

In the first half of 1982, transportation revenues were \$167.0 million as compared with \$153.4 million in 1981. Income from operations was \$24.7 million as compared with \$23.7 million in 1981. The recession in 1982 has resulted in a decline in general commodity freight traffic and grain traffic has declined as well. Kansas City Southern is an important grain hauler and there is no immediate indication that grain movements to the Gulf Coast will improve in the second half of 1982. Long-term grain movements in this country should be substantially higher. The offsetting factor has been increased unit coal train activity to both Welsh, Texas and Mossville, Louisiana. A second generating unit at the Gulf States Utilities plant in Mossville will go on stream in the second half of 1983. We anticipate a moderate upturn in economic activity in the second half of 1982 which will be reflected in improved transportation income. Looking ahead, we expect this railroad to continue to improve its earnings picture. *The railroads long-term coal hauling contracts plus its importance as a grain and chemical*

hauler seem to ensure a continued period of earnings growth. Most important its key geographic location makes it an attractive partner for another major rail system.

NON-RAIL OPERATIONS

Non-rail operations accounted for roughly 17% of revenues and 22% of income from operations in the first half of 1982. Financial services is the main non-rail factor with Pioneer Western Corporation and DST, Inc. being the two companies in this area. Pioneer Western was acquired in 1979 for approximately \$36 million. The company markets life insurance through its subsidiary, Western Reserve Life Assurance Co. of Ohio. Further, Pioneer Western markets other financial services. The company has a field sales force of 1,200 independent agents most of whom are also registered with the National Association of Securities Dealers as well as their respective insurance departments. Pioneer Western has a unique niche in the financial service area and has been a successful and profitable acquisition.

DST, Inc. provides record keeping primarily to the mutual fund industry, but also to investment advisors, banks and insurance companies. The rapid growth of money market funds in recent years has been a boon to DST and should continue so in the future. DST is involved in a number of significant joint ventures — with State Street Bank, Kemper Financial Services, and others — where DST is the dominant operating factor in the venture. We believe that the long-term prospects for the financial services operations are excellent and that they will become increasingly important profit contributors.

Other no-rail operations include Mid America Television Company which owns a CBS affiliate in Jefferson City, Missouri and a NBC affiliate in Peoria, Illinois. We believe both stations represent excellent balance sheet values and have been steady earnings contributors.

There are a number of real estate subsidiaries which have been steady earnings contributors over the years and which are also excellent balance sheet values. The company owns roughly 450,000 shares of Kemper Corp. All in all, the non-rail assets are, in our opinion, an important balance sheet value and are obviously of growing importance as a profit contributor.

CAPITALIZATION

June 30, 1982

		<u>%</u>
Long-Term Debt	\$202,335,000	38.8
Deferred Income Taxes	54,772,000	10.5
Other Liabilities	16,335,000	3.1
Common Shareholders' Equity	<u>248,061,000</u>	<u>47.6</u>
	\$521,503,000	100.0

SELECTED FINANCIAL DATA

	<u>1981</u>	<u>1980</u>	<u>1979</u>	<u>1978</u>	<u>1977</u>
Sales and Revenues (000,000):	\$368.2	\$324.3	\$270.1	\$229.7	\$192.4
Income from Operations (000,000):	65.8	49.4	39.9	33.0	24.0
Equity in Earnings of Western: Reserve Life Assurance Co. (000,000):	5.6	4.8	3.3	—	—
Net Income (000,000):	38.7	30.6	23.9	18.3	11.6
Earnings Per Common Share:	3.95	3.18	2.56	1.96	1.24
Dividends Per Common Share:	0.79	0.625	0.50	0.39	0.25
Stockholder's Equity Per Share:	23.07	19.94	17.49	15.84	14.07
Return on Avg. Stockholders' Equity:	17.9%	16.4%	14.7%	12.7%	8.8%

CONCLUSION

We recommend the common stock of Kansas City Southern for those investors seeking long-term capital appreciation.

AWH/jmh

Alfred W. Harris, Jr.
Research Department

Additional Information is available upon request.

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